

**BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION,**

**Complainant,**

**v.**

**PACIFICORP D/B/A PACIFIC POWER  
& LIGHT COMPANY,**

**Respondent.**

**DOCKET UE-100749**

**REPLY BRIEF ON BEHALF OF COMMISSION STAFF**

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## I. INTRODUCTION

1 Staff's case provides the Commission a strong basis for resolving this case in the public interest, in response to PacifiCorp's very significant 18.7 percent overall revenue increase proposal.

2 As the Commission has surely seen already, while the parties concur on many issues in this case, there are a few areas of sharp disagreement that raise important factual, legal and policy issues. While Staff's case is far from extreme, its proposed revenue increase of 9.5 percent is still quite significant.

3 While Staff's case carefully balances investor and ratepayer interests, PacifiCorp's case does not, particularly in the areas of capital structure and return on equity. In these areas, the Company is asking for far more than is necessary.

4 For example, the Company wants a very high equity ratio, requiring ratepayers to pay every day for extra protection against a severe crisis that may never come, when all the while, PacifiCorp has ample tools to protect the Company from financial hardship and allow it to provide adequate service, should such an event actually occur. As Staff has demonstrated, a more reasonable 46.5 percent ratemaking capital structure is the best balance of ratepayer and investor interests.

5 For the reasons stated in this reply and in Staff's Initial Brief, the Commission should allow PacifiCorp to increase its revenues no more than 9.5 percent, consistent with the rate design and rate spread proposals of Commission Staff.<sup>1</sup>

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<sup>1</sup> The parties give their briefs different names. We use "Initial Brief" as a common descriptor, i.e., "Staff Initial Brief." In addition, Staff's Initial Brief addressed the vast majority of arguments raised by other parties on contested issues. Lack of repetition here should not be construed as agreement with those parties on those issues.

## II. COST OF CAPITAL

### A. Overview

6 As we explained in Staff's Initial Brief, the Commission should accept Staff's 7.48 percent rate of return because Staff presented consistent, credible and transparent analysis, fully in line with Commission policy.<sup>2</sup> By contrast, PacifiCorp's case is mired in contradictions. For example, on capital structure:

- The Company agrees the capital structure standard is safety and economy, but says the Commission must use the Company's actual capital structure, without proof it meets that standard.<sup>3</sup>

7 On return on equity (ROE):

- The Company calls "of little practical use"<sup>4</sup> the 201 basis point range in Mr. Gorman's ROEs,<sup>5</sup> when the range of the Company's own constant-growth DCF results is 598 basis points, almost 300 percent of Mr. Gorman's range.<sup>6</sup>
- The Company maligns Staff's proxy group by speculating that Staff's group may not be statistically reliable,<sup>7</sup> but the Company makes no effort to prove its own proxy group is statistically reliable.<sup>8</sup>

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<sup>2</sup> Staff Initial Brief at 37, ¶ 150 to 51, ¶ 207.

<sup>3</sup> PacifiCorp Initial Brief at 13, ¶ 33.

<sup>4</sup> PacifiCorp Initial Brief at 12-13, ¶ 32, quoting *Utilities and Transportation Commission v. PacifiCorp*, Docket UE-050684, Order 04 (April 17, 2006) at 93, n. 384.

<sup>5</sup> PacifiCorp criticizes Mr. Gorman's results in part because his CAPM results are 105 basis points below his DCF result and 66 basis points below his risk premium result. PacifiCorp Initial Brief at 12-13, ¶ 32. This implies a range of 201 basis points ( $\pm 105$  basis points).

<sup>6</sup> Dr. Hadaway derived a range of ROEs from 7.5 percent to 13.2 percent, a difference of 598 basis points. Hadaway, Exhibit No. SCH-12 at 1, column entitled "Constant Growth DCF Model Analysts' Growth Rates."

<sup>7</sup> PacifiCorp Initial Brief at 8, ¶ 22. Had Dr. Hadaway not eliminated Edison International, the range would be 730 basis points (5.9 percent to 13.2 percent).

<sup>8</sup> Elgin, TR. 720:15-18.



- The Company asserts ROE analysis must be replicable,<sup>9</sup> yet the Company relies on un-replicable analysis, such as analysts' estimates for dividend growth.<sup>10</sup>
- The Company agrees that “[e]stimating the cost of equity is fundamentally a matter of informed judgment,”<sup>11</sup> but complains when Mr. Elgin uses his own judgment, rather than do exactly what prior Staff consultants have done.<sup>12</sup>

8           These basic contradictions that inhere in the Company’s case are not the hallmarks of a credible cost of capital case. The Commission should reject the Company’s case and accept Staff’s 7.48 percent rate of return recommendation.

**B. Capital Structure**

**1. The Commission Should Reaffirm the Standard For a Ratemaking Capital Structure is Safety and Economy, and Place the Burden on the Utility to Satisfy That Standard**

9           PacifiCorp agrees the ratemaking capital structure must “balance debt and equity on the bases of safety and economy,”<sup>13</sup> but the Company promptly changes direction, and argues that in order to depart from the Company’s actual capital structure, there must be a “clear and compelling reason to do so”.<sup>14</sup>

10          The problem with the PacifiCorp’s approach is that there is no *a priori* reason why a utility’s actual capital structure will be safe and economical. If there were such a reason, that would render the Commission’s standard moot. The Commission should simply tell PacifiCorp what it told the Company in Docket UE-050684, the last time cost of capital was

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<sup>9</sup> PacifiCorp Initial Brief at 8, ¶ 22.

<sup>10</sup> Elgin TR. 740:12-15.

<sup>11</sup> Hadaway, Exhibit No. SCH-1T at 4:11-12.

<sup>12</sup> PacifiCorp Initial Brief at 8, ¶¶ 21-22.

<sup>13</sup> PacifiCorp Initial Brief at 13, ¶ 33, quoting *Utilities and Transportation Commission v. Puget Sound Energy*, Docket UE-040641, Order 06 (February 18, 2005) at 13, ¶ 27.

<sup>14</sup> *Id.*, quoting a later PSE order in *Utilities and Transportation Commission v. Puget Sound Energy*, Docket UE-060266, Order 08 (January 5, 2007) at 27, ¶ 76.

fully litigated, and the Company was proposing an increase in its equity ratio to 49.5 percent:

We do not approve an equity share as high as the Company proposes, however, because the Company has failed to prove why such a significant increase in equity - from a historical range of 43 percent to 45 percent to the proposed 49.5 percent - is necessary and economical.<sup>15</sup>

11 In other words, the Commission should once again place the burden where it belongs: on PacifiCorp, to provide in its direct evidence that its proposed run-up to a 52.1 percent equity ratio, plus the elimination of short-term debt, is necessary and meets the safety and economy standard. The Commission should not permit the Company to bootstrap new policies by its new owners as tacit justification for saddling ratepayers with excessive costs.

**2. Staff's Proposed Capital Structure is Safe and Economical and Well Within the Range of Equity Ratios of Staff's Proxy Group**

12 As Staff demonstrated, under its proposed 46.5 percent equity ratio, PacifiCorp would have pre-tax operating income enough to cover fixed interest payment a robust 3.30 times, which proves Staff's capital structure is safe, and it is certainly much more economical than a 52.1 percent equity ratio.<sup>16</sup>

13 The Company counters that pre-tax operating income is not used by credit rating agencies,<sup>17</sup> but this avoids the key point that pre-tax operating income reflects the Company's ability to fund interest expense, and it is the foundation of any cash flow analysis now used by credit rating agencies.<sup>18</sup> It also is the single most important credit

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<sup>15</sup> *Utilities and Transportation Commission v. PacifiCorp*, Docket UE-050684, Order 04 (April 17, 2006) at 83, ¶ 282.

<sup>16</sup> Elgin, Exhibit No. KLE-1T at 17:14.

<sup>17</sup> PacifiCorp Initial Brief at 19, ¶ 48.

<sup>18</sup> Elgin, TR. 710:1-3 and TR. 741:25 to 742:2.

metric used by investors when actually evaluating the ability of the firm to service any new debt issue.<sup>19</sup>

14 The Company then tries to discredit Staff's analysis by focusing on the Company's ROE after all Staff's restating and pro forma adjustments, saying this proves Staff's safety net is insufficient.<sup>20</sup> In fact, this proves only that the Company's filing justifies a rate increase of no more than 9.5 percent. Moreover, ratemaking does not guarantee any specific level of financial performance, and ratepayers should not be required to support excessive equity ratios as a "back door" means to achieve that guarantee, which is the upshot of the Company's argument here.<sup>21</sup>

15 Finally, PacifiCorp deceptively argues that Staff's proxy group has an average projected actual capital structure of 50.4%,<sup>22</sup> when in fact, that figure excludes short-term debt.<sup>23</sup> Simple arithmetic would show that if the Company had included short-term debt consistent with Staff's case, the average would be lower, and consistent with Staff's recommendation of 46.5%. This figure is also consistent with the averages for electric companies reported by AUS and SNL, as Mr. Elgin testified.<sup>24</sup>

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<sup>19</sup> Williams, Exhibit No. BNW-23 at 10, SEC Prospectus: "CONSOLIDATED RATIOS OF EARNINGS TO FIXED CHARGES".

<sup>20</sup> PacifiCorp Initial Brief at 19, ¶ 49.

<sup>21</sup> The Company asserts in its Initial Brief at 19, ¶ 49, "...the danger of Mr. Elgin's recommendation in Washington where PacifiCorp historically has fallen far short of earning its allowed ROE." In other words, the essence of the Company's case on capital structure is its apparent belief that it is guaranteed to earn its allowed ROE.

<sup>22</sup> PacifiCorp Initial Brief at 14, ¶ 36.

<sup>23</sup> The Company's figure comes from Value Line data. Exhibit No. BNW-9 at 10 is a sample Value Line report. The right hand column contains projected data ("13-15", meaning "2013 - 2015"). The capital ratios are labeled "Long-Term Debt Ratio" and "Common Equity Ratio".

<sup>24</sup> Elgin, Exhibit No. KLE-1T at 16:9-13; Williams, Exhibit No. BNW-10 at 2 - see circled text at bottom of that page.

**3. PacifiCorp's Actual Structure May be Safe, But it is Not Worth the Cost; There are Other Ample, Proven Regulatory Means to Protect the Company and its Ratepayers in Times of Financial Distress**

16 Staff understands that an equity ratio of 52.1 percent adds more safety and flexibility,<sup>25</sup> but the issue is the cost ratepayers must pay for all that.<sup>26</sup> Moreover, we question whether ratepayers even need that additional safety, given the plethora of regulatory tools at PacifiCorp's disposal, should the Company experience financial hardship.

17 Staff's analysis shows that under a 52.1 percent equity ratio, ratepayers would be saddled with annual costs of \$5.1 million for this added flexibility.<sup>27</sup> Interest costs would have to be 113 basis points higher to offset these added costs;<sup>28</sup> yet, the spread between A and BBB ratings averages only about 40 basis points.<sup>29</sup>

18 The Company serves up the recent financial crisis in a lengthy attempt to justify an equity ratio well into the 50s,<sup>30</sup> but as the Company conceded, that event was "unprecedented by any measure".<sup>31</sup> The Commission should not accept an equity-laden capital structure designed to address once-in-a-lifetime events, for the same reason no one builds 20-lane freeways to handle the 100-year traffic jam: There are better uses of that money.

19 In fact, the Commission has a long history of providing relief when the circumstances require it, rendering a bloated 52.1 percent equity ratio unnecessary. The commonly-used mechanisms include filing a general rate case or perhaps seeking deferred

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<sup>25</sup> Elgin, Exhibit No. KLE-1T at 50:15-19.

<sup>26</sup> Id.

<sup>27</sup> Elgin, Exhibit No. KLE-1T at 51:22.

<sup>28</sup> Elgin Exhibit No. KLE-1T at 51:3. As Mr. Gorman explained to the bench, when the equity ratio increases, the debt ratio decreases, and ratepayers lose the tax benefit of the debt that has been replaced. TR. 474:10-19. Staff took this impact into account.

<sup>29</sup> Gorman, TR. 474:1-2.

<sup>30</sup> PacifiCorp Initial Brief at 4, ¶ 10 to 6, ¶ 14.

<sup>31</sup> Williams, TR. 288:19-21.

accounting, but other mechanisms include procedures such as interim rate relief, and even breaking a rate plan, like the Company did not so long ago.<sup>32</sup>

20 In sum, there is simply no need for the Commission to reward PacifiCorp's owners with a 52.1 percent ratemaking equity ratio that would make customers pay each and every day for "crisis" protection they may never need. The Commission should use a more reasonable 46.5 percent common equity ratio, which is "firmly investment grade" and consistent with the capital structure parameters for the credit ratings enjoyed by the "predominance" of electric utilities in this country,<sup>33</sup> and keep available to PacifiCorp all regulatory tools designed to protect the utility if and when it needs that protection.

**C. The Commission Should Reject PacifiCorp's ROE Because the Company Has Not Defended its Proxy Group, and It Cannot Defend That Group**

21 Staff and Company agree it is critical for the proxy group to contain companies of comparable risk,<sup>34</sup> but nowhere does PacifiCorp prove why its own proxy group meets that standard. Instead, PacifiCorp attacks Staff's proxy group by repeating Dr. Hadaway's conjecture that Staff's proxy group might not be statistically reliable.<sup>35</sup> However, as we noted earlier, not only does PacifiCorp offer zero support for that conjecture, the Company offers no statistical support for its own group, to boot.<sup>36</sup>

22 The Commission needs no statistics to decide the Company's proxy group is unrepresentative, because PacifiCorp's own DCF results prove it: Dr. Hadaway's proxy group produces a range of ROEs from 7.5 percent to 13.2 percent, a difference of 598 basis

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<sup>32</sup> E.g., Elgin, TR. 744:6-14 and Williams, TR. 278:12-24 (PacifiCorp breaking a rate plan)..

<sup>33</sup> Williams, Exhibit No. BNW-17 at 1 (per S&P): "predominance of ratings is in the 'BBB' category, firmly investment grade."

<sup>34</sup> PacifiCorp Initial Brief at 9, ¶ 24.

<sup>35</sup> PacifiCorp Initial Brief at 8, ¶ 22.

<sup>36</sup> Given the nature of the analysis and the judgment used to establish criteria for a proxy group, Staff doubts a statistical analysis could be done in this context. Elgin, TR. 720:15-18.

points.<sup>37</sup> While Dr. Hadaway may hope his “problem data” properly balances out,<sup>38</sup> there is no proof that it does. The credible approach is to start with a representative group in the first place, which only Staff has done in this case.

23 PacifiCorp also criticizes Staff’s proxy group by comparing it to the proxy groups and approaches used by prior Staff consultants.<sup>39</sup> While PacifiCorp neglects to mention that those prior Staff witnesses simply accepted the Company’s proxy group to avoid controversy,<sup>40</sup> the more important point is that Staff witness Mr. Elgin provided the Commission his best judgment on the cost or equity for PacifiCorp. Nothing requires him, Dr. Hadaway, or any other witness, to do what a prior witness did in furtherance of their own exercise in judgment.

**D. Staff’s ROE Analysis is Replicable; The Company’s is Not**

24 The Company’s criticism that Mr. Elgin’s ROE analysis is “not subject to replication”<sup>41</sup> is completely unfounded because Mr. Elgin fully explained his analysis.<sup>42</sup> The Company should have applied its “subject to replication” concept to its own case. If the Company did so, it would have no case on ROE, because there is absolutely nothing in the record to replicate even a single analyst forecast relied on by Dr. Hadaway. As Mr. Elgin testified:<sup>43</sup>

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<sup>37</sup> Hadaway, Exhibit No. SCH-12 at 1, column entitled “Constant Growth DCF Model Analysts’ Growth Rates.” Had Dr. Hadaway not eliminated Edison International, the range would be 730 basis points (5.9 percent to 13.2 percent).

<sup>38</sup> Hadaway, TR. 255:8-11.

<sup>39</sup> PacifiCorp Initial Brief at 8, ¶¶ 21-22.

<sup>40</sup> E.g., Elgin, Exhibit No. KLE-5 at 4:3-4 (testimony of Staff consultant Parcell, selecting a proxy group so as “not [to] form a major controversy in the cost of equity estimation process”); Elgin, Exhibit No. KLE-6 at 3:7-8, (Mr. Rothschild used Dr. Hadaway’s group “to reduce controversy.”)

<sup>41</sup> PacifiCorp Initial Brief at 8, ¶ 22.

<sup>42</sup> Elgin, TR. 739:21-25. Mr. Elgin explained his analysis in this direct testimony. If PacifiCorp did not understand what Mr. Elgin did, or had questions about it, the Company should have asked him.

<sup>43</sup> Elgin, TR. 740:12-15.

Q. Did [Dr. Hadaway] provide a basis for each of those analysts' estimates in the same manner you [Mr. Elgin] provided the basis for your estimates?

A. No, he did not.

25 Dr. Hadaway made other important judgments in this case, each of which had the effect of moving his ROE estimate higher, and none of which can be replicated.<sup>44</sup>

**E. PacifiCorp's Undefended Use of Six Percent GDP Growth Renders the Company's ROE Results Untenable**

26 As we explained in our Initial Brief, because PacifiCorp's initial constant growth DCF produced such tenuous results, the Company reverted to more complex DCF calculations and used a proxy for long-term DCF to stabilize those results.<sup>45</sup> Dr. Hadaway chose GDP growth as that proxy, and PacifiCorp now attempts to defend his use of historical GDP data<sup>46</sup> by insisting he simply used that data as a "proxy" for a forecast.<sup>47</sup> If so, that "forecast" calls for heavy fog, because there is no clear support for it.<sup>48</sup>

27 For example, PacifiCorp tries to defend Dr. Hadaway by simply describing that he gave weight to more recent data in the 60-year data set,<sup>49</sup> that just exposes the core problem for PacifiCorp. For example, "giving more weight to more recent data" would also justify

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<sup>44</sup> Examples: Dr. Hadaway chose to reject CAPM (Exhibit No. SCH-33:12 to 34:8). He also chose to reject the estimate of a 5.9% ROE for Edison International because it was too low, yet he chose to leave in an ROE estimate of 13.2% for Empire District, which is by far the highest ROE in his group (Exhibit No. SCH-12 at 1). A 13.2% estimate for ROE clearly does not pass Dr. Hadaway's "smell test," i.e., one of his criterion for determining whether to eliminate data. It is also revealing that Dr. Hadaway chose to criticize Mr. Gorman for failing to remove an "outlier" (Exhibit No. SCH-24:5-9), when removing that value supported the Company. Notably, each one of these judgment calls made by Dr. Hadaway worked to increase his ROE estimate, and each one of these judgment calls cannot be reconciled with the "replicable" concept PacifiCorp advances in its Initial Brief.

<sup>45</sup> Staff Initial Brief at 48, n. 284.

<sup>46</sup> PacifiCorp Initial Brief at 10-12, ¶¶ 27-30.

<sup>47</sup> PacifiCorp Initial Brief at 12, ¶ 30, last sentence.

<sup>48</sup> We note at this juncture that PacifiCorp abuses the record by suggesting Staff characterized Dr. Hadaway's GDP calculation as a "simple average" (PacifiCorp Initial Brief at 10, ¶ 27), when Mr. Elgin unambiguously and accurately testified that Dr. Hadaway "simply used the average of the last 60 years cumulative decade averages of GDP growth." Elgin, Exhibit No. KLE-1T at 55:9-13.

<sup>49</sup> PacifiCorp Initial Brief at 11, ¶ 27.

Dr. Hadaway using, say, the cumulative average of GDPs for each of the last three decades, i.e., 4.97 percent,<sup>50</sup> resulting in DCF results in the mid-nine percent range.<sup>51</sup>

28           What it boils down to is that PacifiCorp has no evidence that Dr. Hadaway's method for giving weight to more recent years' GDP data is better than anyone else's method. There is no basis on this record for defending any one of the many weighting schemes one could use.

**F.   PacifiCorp's Speculation About Recent Market Volatility Does Not Justify a Higher ROE, Because Investors Have Already Taken That Into Account, as Reflected in the Prices Used in Each DCF Analysis in This Case**

29           PacifiCorp points to utility stock volatility since 2006, and speculates this will increase investors' equity return requirements.<sup>52</sup> The Company misses the point, because investors have taken all economic factors into account in making their investment decisions, including the experience of the last few years, and this knowledge is fully reflected in the stock prices and other financial information investors use to set their required rates of return.<sup>53</sup>

30           The key is the proper analysis of those stock prices and accompanying data. PacifiCorp agrees "it is undisputed that utility stock prices and returns are an important consideration in determining ROE,"<sup>54</sup> and in fact, every DCF analysis relies upon current market prices for estimating investor return requirements.

31           In short, there is no room for PacifiCorp's speculation that investor's required returns will be higher, because every estimate of expected dividend yield in the DCF equation has captured the impact of recent economic events.

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<sup>50</sup> Hadaway, Exhibit No. SCH-5, % change column,  $4.2\% + 4.9\% + 5.8\% = 14.9$ ;  $14.9 \div 3 = 4.97\%$ .

<sup>51</sup> Elgin, Exhibit No. KLE-1T at 56:19-26.

<sup>52</sup> PacifiCorp Initial Brief at 5-6, ¶ 13.

<sup>53</sup> Elgin, Exhibit No. KLE-1T at 7:16-21.

<sup>54</sup> PacifiCorp Initial Brief at 5, ¶ 10.



**G. The Commission Should Use Sparingly, if at all, ROE Results Based on Records Not Before the Commission in This Case, and the Commission Should Disregard Settlement Results Entirely**

32 PacifiCorp argues Staff's and ICNU's ROEs are too low, by comparing ROEs from Commission settlements and litigated results, and results from decisions by commissions around the country.<sup>55</sup> As the Commission has doubtless already observed, this Company argument impeaches its own 10.6 percent ROE, which is higher than each and every figure the Company quotes in that section of its brief.

33 Staff understands how tempting it may be for the Commission to look at this sort of information, but the Commission should consider that information, if at all, with a jaundiced eye, because the Commission does not have before it the records upon which those returns were based. Certainly, it is simply improper to rely on settlement results, not only because that violates ER 408, but it also violates the terms of those settlements.<sup>56</sup>

34 Moreover, if every commission relied on what other states were doing in terms of ROE, the authorized ROE would not change, or if it did, it would only change begrudgingly.

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<sup>55</sup> PacifiCorp Initial Brief at 9-10, ¶¶ 24-26.

<sup>56</sup> PacifiCorp apparently would justify this violation of ER 408 by saying the Commission cited settlement ROEs once, and Staff witness Mr. Buckley referred to a settlement on a non-ROE issue in his direct testimony in this case. (PacifiCorp Initial Brief at 9, ¶ 25, n. 66 and 67, citing *Utilities and Transportation Commission v. PacifiCorp*, Docket UE-050684, Order 04 (April 17, 2006) at 95, ¶ 263, n. 390, and Buckley, Exhibit No. APB-1T at 16-18, respectively). In response, Staff strongly encourages the Commission not to rely on settlements as precedent, unless the settlement itself permits that. For starters, the Commission should either strike or disregard Mr. Buckley's direct testimony at page 16:13-16 (Staff does not rely on that portion of Mr. Buckley's testimony).

The settlements themselves preclude giving them precedential effect due to "no precedent" clauses. The Commission-approved Stipulation in Docket UE-090205 contains an example of such a clause, wherein the parties (including PacifiCorp) agreed the Stipulation would not be used to resolve any issue in any other proceeding. *Utilities and Transportation Commission v. PacifiCorp*, Docket UE-090205, Order 09 (December 16, 2009) Settlement Stipulation at 11-12, ¶ 34. Moreover, the ROE stated in that Stipulation was agreed to "for reporting and/or accounting purposes" only. *Id.* at 5-6, ¶ 16. That Stipulation further states: "the parties do not agree on the ... cost of any capital structure component." *Id.* at 5, ¶ 16.

The bottom line is that PacifiCorp's use of settlement ROEs violates each Stipulation the Company cites. If these settlements, the settlement process and the Commission's pro-settlement policies are to have any integrity, this practice should stop.

That disserves both ratepayers in present times, when capital costs have declined, and it would disserve the utility, if the opposite should occur.

35           The Company also uses the recently litigated ROE result of 10.1 percent in PSE Docket UE-090704 to suggest Staff's 9.5 percent ROE is too low.<sup>57</sup> Obviously, the Company's use of this data point also means PacifiCorp's 10.6 percent POE is excessive by a large margin, but more importantly, this Company argument proves Staff point that using this data point unfairly discounts the objective of the hearing process in this case: to inform the Commission of relevant data and expert opinion about PacifiCorp's cost of capital, not PSE's cost of capital decided on some other record, or of some utility in a distant state.

**H.    The Commission Should Reject the Company's Attempt to Malign Staff's ROE Witness for Providing His Informed Judgment**

36           The Company agrees "[e]stimating the cost of equity is fundamentally a matter of informed judgment,"<sup>58</sup> but criticizes Mr. Elgin for exercising his own judgment, rather than do the same thing prior Staff consultants did.<sup>59</sup> The fact is, Mr. Elgin provides the Commission his informed judgment, and he explains every judgment he made and figure he used. The same cannot be said for the Company, who relied on unexplained analysts' forecasts and an arbitrary weighting of historical GDP growth.

37           Finally, PacifiCorp correctly notes that in his response to a question from Chairman Goltz, Mr. Elgin said he "struggled", but the Company fails to recognize that Staff's "struggle" here is due to the fact that commissions seem reluctant to find an ROE less than 10 percent when the data justify it:

... in these past five, six years I think the cost of capital has come down and, particularly, after the financial crisis and with this steadying and, in my mind, the

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<sup>57</sup> PacifiCorp Initial Brief at 7-8, ¶¶ 19-20.

<sup>58</sup> Hadaway, Exhibit No. SCH-1T at 4:11-12.

<sup>59</sup> PacifiCorp Initial Brief at 8, ¶¶ 21-22.

opportunity costs which is -- you heard testimony about this in the PSE case. My [recommendation] to you is that, based on the evidence, a strong order regarding your findings about the growth and the dividend yields and these economic circumstances, at some point some Commission will have to go there [below 10 percent ROE]. And my recommendation to you is that this is the time and these are the circumstances to make a finding that nine-and-a-half truly is sufficient compensation for the equity owners of PacifiCorp.

38           The Commission should accept the reality that capital cost have declined, and accept Staff's rate of return of 7.48 percent for PacifiCorp, based on a capital structure containing 46.5 percent equity at a cost of 9.5 percent, and three percent short term debt.

### III. REVENUES

#### A. ICNU/Public Counsel's Residential Revenues Adjustment Is a Departure From the Agreement They Signed in Docket UE-090205

39           ICNU/Public Counsel offer argument on their Residential Revenues Adjustment,<sup>60</sup> but they fail to address the key evidence: Mr. Schooley's filed testimony that refutes their adjustment by fully explaining the difference between temperature normalized usage and actual usage.<sup>61</sup> Consequently, we are left to reply only to ICNU/Public Counsel's reliance and emphasis on language from the Commission-approved Stipulation in Docket UE-090205, wherein the parties agreed the temperature normalization methodology "*faces further scrutiny by the parties.*"<sup>62</sup>

40           Apparently, ICNU/Public Counsel want the Commission to believe their adjustment constitutes "scrutiny" of the Company's temperature normalization methodology for purposes of the Stipulation, but that is not possible, because their witness, Mr. Meyer, was not even aware of the Stipulation:

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<sup>60</sup> Public Counsel Initial Brief at 26, ¶ 52. ICNU concurs. ICNU Initial Brief at 58, ¶ 109.

<sup>61</sup> Schooley, Exhibit No. TES-4T at 2 to 6:13 as clarified on one point in Exhibit No. TES-6T at 1:14 to 2:5.

<sup>62</sup> Public Counsel Initial Brief at 28, ¶ 54 (emphasis by Public Counsel), quoting *Utilities and Transportation Commission v. PacifiCorp*, Docket UE-090205, Order 09 (December 16, 2009) at 21, ¶ 60 (Staff cannot confirm Public Counsel's cite to ¶ 61 of that order).

Q. Are you familiar with the stipulation in the Company's 2009 rate case in Washington?

A. No, I'm not.<sup>63</sup>

41 As Mr. Meyer frankly conceded: "There is not a discussion in my testimony directed towards a specific argument against the Company's methodology for weather normalization."<sup>64</sup>

42 ICNU and Public Counsel signed the Stipulation in Docket UE-090205. At a minimum, the Commission should expect them to work within the framework of what they agreed to. For that reason alone, the Commission should reject their Residential Revenues Adjustment, though Staff provided many sound reasons for the Commission to reject that adjustment on its merits.<sup>65</sup>

**B. A PCAM is Not a Prerequisite to Accepting Staff's Renewable Energy Credit Recommendation Because the Credits Represent a Sale of the Environmental Attributes of the Wind Facilities**

43 Staff's position on Renewable Energy Credits (RECs) is generally consistent with the positions of ICNU and Public Counsel. However, Staff cannot agree to the \$10 million REC figure advanced by ICNU.<sup>66</sup> It appears ICNU derived this figure by doubling the REC revenues from the first six months of 2010.<sup>67</sup> Staff believes the use of actual test year REC levels plus the regulatory liability account is a preferable way of capturing the relevant revenues.

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<sup>63</sup> Meyer, TR. 487:2-3.

<sup>64</sup> Meyer, TR. 489:16-18.

<sup>65</sup> Staff Initial Brief at 4-6, ¶¶ 16-22.

<sup>66</sup> ICNU Initial Brief at 19, ¶ 34.

<sup>67</sup> Id. ICNU cites Exhibit No. RJF-8CT at 6:1-4 as the source for the \$10 million figure.

44 Staff addressed the Company's three arguments in opposition to giving ratepayers their fair share of RECs.<sup>68</sup> PacifiCorp also thinks Staff's regulatory liability account proposal "violates the matching principle" unless the Company has a PCAM-type mechanism to track the power costs associated with the facilities that give rise to REC revenues.<sup>69</sup>

45 PacifiCorp is wrong. While we note the calculation of net power costs captures the costs of these wind facilities, that is beside the point, because matching is not the issue. The RECs represent the "monetary value of the environmental attributes of the electricity PacifiCorp generates" from its wind facilities.<sup>70</sup> In effect, RECs are a benign byproduct of those facilities, which is proved by the fact RECs do not affect the dispatch of the wind facilities themselves. Consequently, the revenue from the sale of those attributes is a separate item the Commission can and should treat separately, analogous to the situation if PacifiCorp sold the naming rights to these facilities.

46 Staff's position is simple: Return to ratepayers the revenues from the sale of RECs by means of a test year adjustment and a regulatory liability account. This is fair, reasonable and satisfies the Commission's policy determination in the recent PSE order.

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<sup>68</sup> Staff Initial Brief at 7, ¶ 26 to 10, ¶ 38 (i.e., Staff addressed the alleged "double-counting," the "pseudo-actual" issue, and retroactive ratemaking.)

<sup>69</sup> PacifiCorp Initial Brief at 26, ¶ 67.

<sup>70</sup> Foisy, Exhibit No. MDF-1CT at 8:8-10.

#### IV. EXPENSES

##### A. ICNU/Public Counsel's Opposition to the Wage and Salary Adjustments is Based on Errors and Misapplied Precedent

###### 1. Annualization Adjustment and Pro Forma Adjustment

47 ICNU/Public Counsel<sup>71</sup> try to buttress their opposition to both the Company's restating and pro forming of the 3.5 percent wage increase that actually occurred in 2009, by pointing the Commission to newspaper articles and two decisions from other states, but that support is both frail and flawed.

48 For example, ICNU/Public Counsel erroneously claim median CEO salaries decreased "nine percent" in 2009,<sup>72</sup> when the actual number is ten times less: 0.9 percent.<sup>73</sup> They also fail to point out the same article says this "trend" terminated in March 2009.<sup>74</sup>

49 The two decisions ICNU/Public Counsel cite are from the Connecticut and New York commissions. ICNU/Public Counsel views those decisions as evidence of an "across the country" trend of executive pay increase denials,<sup>75</sup> but two decisions can hardly be proof of a trend. Moreover, a close examination of those decisions actually confirms the pro forma wage adjustment in this case is not unreasonable.

50 First, ICNU/Public Counsel point to the Connecticut commission's decision in *Re The United Illuminating Co.*,<sup>76</sup> but fail to disclose that the wage increases disallowed there "[ranged] between 4% for all non-executive employees, both union and non-union, and 5%

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<sup>71</sup> Public Counsel Initial Brief at 11-12, ¶¶ 23-26. ICNU concurs. ICNU Initial Brief at 58, ¶ 109.

<sup>72</sup> Public Counsel Initial Brief at 11, ¶ 23.

<sup>73</sup> The 0.9 percent figure is in Mr. Wilson's Exhibit No. EDW-19 at 1, second new ¶.

<sup>74</sup> "Pay curbs appear to be ending. Several companies recently thawed frozen salaries or canceled pay cuts." (Wilson, Exhibit No. EDW-19 at 2, last ¶). In other words, on a going forward basis, i.e., on a pro forma basis, this pay decline is reversing.

<sup>75</sup> Public Counsel Initial Brief at 12:24-26.

<sup>76</sup> 271 PUR 4<sup>th</sup> 185 (Conn. Dep't of Util. Control 2009).

to executives”<sup>77</sup>; which are higher than the 3.5 percent increase at issue here. In fact, in that case, the Connecticut commission approved a two percent wage and salary increase, called a “base annual escalation factor”,<sup>78</sup> which effectively granted a four percent increase over the two-year rate period at issue in that case,<sup>79</sup> which also exceeds the 3.5 percent increase at issue here.

51           The decision by the New York Public Service Commission in *Re Central Hudson Gas & Elec. Co.*,<sup>80</sup> is inapposite, not only because it is a settlement, but also because it involved a commission-required “[compliance] with austerity guidelines that require belt-tightening beyond that imposed by our usual regulatory oversight.”<sup>81</sup> The New York commission previously had ordered utilities to submit “austerity plans” based on each utility’s examination of its capital expenditures, operation and maintenance expenses, and any other costs “that may be reduced without impairing the ability to provide safe and adequate service.”<sup>82</sup>

52           Like it or not, this Commission simply has no similar guidelines to impose upon PacifiCorp in this case.

53           ICNU/Public Counsel also challenge the workforce level used to calculate the pro forma adjustment,<sup>83</sup> but fail to mention that over the period 2004-2010, the total full-time equivalents has both increased and decreased, but overall, has been very stable.<sup>84</sup>

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<sup>77</sup> Id. at 222.

<sup>78</sup> Id.

<sup>79</sup> Id. at 195.

<sup>80</sup> 2010 WL 2546853 (N.Y.P.S.C.).

<sup>81</sup> Id. at 4.

<sup>82</sup> *Re Development of Utility Austerity Programs*, Case 09-M-0435, Notice Requiring the Filing of Austerity Plans (N.Y. PSC 2009) at 2, first ¶. Notably, the commission required those plans to address the appropriate allocation of the austerity cost savings between customers and shareholders and the mechanism proposed to deliver the customer portion of these savings to customers as promptly as possible.” Id. at 2, second ¶. ICNU/Public Counsel does not offer any sharing of the costs reduced via their adjustments.

<sup>83</sup> Public Counsel Initial Brief at 14, ¶ 29, including Chart 1.

## 2. Annual Incentive Plan (AIP)

54 ICNU/Public Counsel object to 50 percent of the AIP payments, claiming those payments “provide no benefit” to ratepayers,<sup>85</sup> yet the sample employee evaluation in Exhibit No. EDW-4 demonstrates that individual goals address such areas as safety, efficient operations, and environmental safeguards, which confers obvious ratepayer benefit.

55 Neither do ICNU/Public Counsel address the fact that absent AIP payments, the employees would receive their full salary anyway.<sup>86</sup> Put another way, they ignore the directive the Commission laid down in PacifiCorp Docket UE-050684: “The ultimate issue is whether total compensation is reasonable and provides benefits to ratepayers ...”<sup>87</sup>

56 Instead, ICNU/Public Counsel rely on an 18 year-old order involving Washington Natural Gas Company (WNG).<sup>88</sup> While the more recent Commission order in Docket UE-050684 we just quoted appears to trump that WNG order, ICNU/Public Counsel nonetheless fail to demonstrate that the plans at issue there are similar to the “at risk pay” plan at issue here, and also fail to explain why 50 percent is the correct level of disallowance, in any event.

### B. Staff’s Net Power Cost Adjustments are Reasonable

57 Staff’s Initial Brief contains a detailed demonstration why Staff’s Net Power Cost adjustments are reasonable.<sup>89</sup> The Company’s Initial Brief justifies a Staff reply in a few specific areas.

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<sup>84</sup> Dalley, Exhibit No. RBD-12 at 2,

<sup>85</sup> Public Counsel Initial Brief at 16-17, ¶¶ 33-34.

<sup>86</sup> Staff Initial Brief at 14, ¶ 58.

<sup>87</sup> *Utilities and Transportation Commission v. PacifiCorp*, Docket UE-050684, Order 03 (June 9, 2005) at 48, ¶ 128.

<sup>88</sup> Public Counsel Initial Brief at 16, ¶ 33, quoting *Utilities and Transportation Commission v. Washington Natural Gas Co.*, Docket UG-920840, Fourth Supplemental Order (September 27, 1983) at 19.

<sup>89</sup> Staff Initial Brief at 15, ¶ 64 to 25, ¶ 102.



58 ICNU's Initial Brief raises many of the same issues as Staff.<sup>90</sup> Though ICNU views some of these adjustments as appropriate changes to the West Control Area (WCA) allocation methodology, Staff views these more as normal ratemaking adjustments. However, regardless of how these adjustments are characterized, it is appropriate for the Commission to consider them. To do otherwise would improperly allow the WCA allocation method to triumph over the Commission's statutory obligation to set fair, just and reasonable rates.

**1. Arbitrage Sales Margins**

59 PacifiCorp argues Staff double-counts revenues by including arbitrage transactions in the GRID model,<sup>91</sup> but these arbitrage transactions are different than the balancing sales and purchase transaction in GRID. Arbitrage transactions are low to no risk buy/sell arrangements that Staff has identified in discovery. We re-emphasize that Staff asked the Company to defend its position by quantifying the level of arbitrage transactions in GRID. The Company failed to do so,<sup>92</sup> so the Commission should reject the Company's argument on burden of proof grounds.

60 PacifiCorp also suggests if the Commission accepts Staff's adjustment, then trading transactions should also be included in GRID,<sup>93</sup> but trading transactions are different; they are more risky and speculative transactions that may or may not provide revenues. The Company should keep the costs and enjoy the benefits of these types of speculative transactions.

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<sup>90</sup> ICNU raises some issues Staff does not address. These are listed in Appendix B to PacifiCorp's Initial Brief as follows: 11 (Eastern Market Modifications); 12 (Colstrip Wheeling Expense); 17 (Bridger Plant Fuel Derations); 18 (Hermiston Planned Outage Schedule); and 20 (Minimum Loading and Deration). Staff takes no position on these issues.

<sup>91</sup> PacifiCorp Initial Brief at 27, ¶ 70.

<sup>92</sup> Duvall, Exhibit No. GND-18.

<sup>93</sup> PacifiCorp Initial Brief at 27, ¶ 70.

61 The Company then suggests Staff's adjustment is excessive because it is based on a four-year average, and the more recent period transactions are lower.<sup>94</sup> Of course, this is no reason to exclude *all* arbitrage transactions, as PacifiCorp proposes. Moreover, like many normalizing adjustments, the use of an average evens out periods of high and low levels of transactions. PacifiCorp offers no explanation why the four-year average level is not a reasonable indicator of future experience.

## 2. SMUD Contract Shaping

62 PacifiCorp's argument regarding the shaping of the SMUD contract ignores the fact that actual deliveries under the SMUD contract show a clear pattern, and thus, there is no reason not to model that pattern. This is very different from a resource or contract whose utilization is expected to vary over the periods used in the net power supply normalization process, depending on market conditions for fuel and energy.

## 3. Colstrip Outage Adjustment

63 PacifiCorp thinks the use of Staff's Colstrip outage rate will result in an "abnormally low" outage rate,<sup>95</sup> but we ask the Commission to simply take a look at Exhibit GND-17C for itself. The Commission will find Staff's eight percent outage rate is rather conservative in PacifiCorp's favor,<sup>96</sup> unless the Commission wants to give an abnormal 25 percent weighting to the unprecedented outage that occurred last year. Curiously, PacifiCorp does not refer to Exhibit No. 17C in its brief, though that exhibit is the key evidence on this issue.

64 PacifiCorp goes on to make a tardy request for deferred accounting of costs related to the unprecedented Colstrip outage.<sup>97</sup> A post-hearing brief is simply too late to raise such

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<sup>94</sup> PacifiCorp Initial Brief at 28, ¶ 72.

<sup>95</sup> PacifiCorp Initial Brief at 35, ¶ 87.

<sup>96</sup> Buckley, TR. 582:1 to 582:12.

<sup>97</sup> PacifiCorp Initial Brief at 36, ¶ 89.

a request, and the Company's request is also ill-defined. Should the Company ever choose a more appropriate vehicle for such a request, that request must include an analysis of actual power costs during the period in question compared to what was imbedded in rates, including any mitigating costs, such as lower gas prices, market prices, favorable water conditions, etc.

65 In other words, the Colstrip outage cost issue is a two way street, because it can result in benefits that offset the costs. The Commission should not allow the Company to treat this as a one-way street that turns into a dead end for ratepayers.

#### **4. Idaho PTP Contract**

66 PacifiCorp suggests Staff did not understand the Company had already removed costs associated with the East control area,<sup>98</sup> but Staff understood that. Both Staff and ICNU are simply making a further adjustment to the remaining costs the Company has allocated to the WCA. That adjustment addresses the benefits that the East gets from the West-allocated portion of the contract.

#### **5. DC Intertie**

67 The Company's arguments fail to address the basic fact that, on a normalized basis, the Company needs to demonstrate there are sufficient benefits to cover the costs of this contract, at a minimum. The Commission should not accept the Company's claims that the contract provides "benefits" on a normalized basis,<sup>99</sup> without requiring the Company to quantify those benefits.

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<sup>98</sup> PacifiCorp Initial Brief at 30, ¶ 77.

<sup>99</sup> PacifiCorp Initial Brief at 31, ¶ 79.

## 6. Wind Integration Costs

68 PacifiCorp urges the Supremacy Clause and the filed rate doctrine mandate the Commission hold Washington retail customers responsible for costs caused by the non-owned wind generators that pay PacifiCorp pursuant to the Company's OATT.<sup>100</sup>

69 However, this is not an instance where the Commission would fail to recognize a filed rate or refuse to pass through a federally-approved rate. This is a case where PacifiCorp incurs a cost associated with serving those interstate customers, and is seeking to pass that cost along to Washington ratepayers, which is an entirely different matter.

70 In a case relied on by PacifiCorp,<sup>101</sup> *Westar Energy, Inc.*,<sup>102</sup> FERC allowed a utility to recover these wind integration costs from third-party wind facility owners. Thus, the issue for FERC is the quantification of the costs, not who is responsible for them.

71 This situation is more analogous to *Louisiana Public Service Commission v. FCC*,<sup>103</sup> where the FCC tried to dictate state policies for depreciation of intrastate telecommunications facilities. The Supreme Court rejected the FCC's attempts to delve into intrastate ratemaking because Congress intended a dual federal/state regulatory system under the Telecommunications Act.<sup>104</sup>

72 The Federal Power Act also reflects a dual federal/state regulatory system.<sup>105</sup> This case presents a situation where PacifiCorp is seeking to pass along costs to the intrastate

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<sup>100</sup> PacifiCorp Initial Brief at 33, ¶ 82, citing *Nantahala Power and Light Co., v. Thornberg*, 476 U.S. 953 (1986); *Cogeneration Ass'n of Cal. v. FERC*, 525 F.3d 1279 (D.C. App. 2008), *Miss. Power & Light Co. v. State of Miss.*, 487 U.S. 354 (1988) and 16 U.S.C. § 791, et seq.

<sup>101</sup> PacifiCorp Initial Brief at 34, n. 236.

<sup>102</sup> Docket ER 09-1273-000, 130 FERC (May 18, 2010).

<sup>103</sup> 476 U.S. 355 (1986).

<sup>104</sup> 476 U.S. at 370.

<sup>105</sup> In basic terms, the Federal Power Act confers federal jurisdiction over transmission of electricity in interstate commerce (16 U.S.C. §824(a)), and sales of electricity at wholesale in interstate commerce (16 U.S.C. §824(b)(1)), but preserves state jurisdiction over facilities used for the generation of electricity or over facilities used in local distribution of electricity (16 U.S.C. §824(b)(2)).

regulatory sphere (i.e., Washington retail customers), that plainly belong in the interstate regulatory sphere.

73 In sum, nothing in the Constitution or the filed rate doctrine forces the Commission to recognize such a cost.<sup>106</sup>

## V. RATE BASE

### A. Staff's Working Capital Adjustment is Consistent With the WCA Allocation Method, But if the Commission's Policy is Against Using Figures Allocated From System Results, the Commission Should Reject Both Company and Staff Adjustments

74 As we explained in Staff's Initial Brief, Staff's investor-supplied working capital adjustment calculates the working capital investors provide, and is consistent with the West control area allocation method.<sup>107</sup>

75 PacifiCorp attacks Staffs working capital analysis on the basis it uses PacifiCorp's balance sheet as a starting point,<sup>108</sup> but then defends the Company's own 1/8<sup>th</sup> method's use of the SO allocation factor, which allocates total Company costs to Washington.<sup>109</sup>

76 These Company positions are self-contradictory, because the SO factor uses the total Company figures from balance sheet, too, as well as the income statement. In other words, the Company cannot have it both ways; if allocating system costs is acceptable for defending the Company's method, then it must be acceptable for defending Staffs' method. If that is not acceptable, then both Staff and Company methods are inadequate.

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<sup>106</sup> It may well be that, sometime in the future, the Company will need to allocate the costs and revenues for this activity to interstate, similar to how utilities in the telecommunications industry use accounting separations to address these jurisdictional issues.

<sup>107</sup> Staff Initial Brief at 26, ¶ 110 to 28, ¶ 115.

<sup>108</sup> PacifiCorp Initial Brief at 47-48, ¶¶ 112-114.

<sup>109</sup> PacifiCorp Initial Brief at 49, ¶ 117.

77            Apart from the calculations, nowhere does the Company argue that the 1/8<sup>th</sup> method derives the amount of working capital supplied by investors, which dooms the Company's method, anyway.<sup>110</sup>

## VI. FEDERAL INCOME TAX

### A. The Commission Should Reject PacifiCorp's Request for Full Normalization Because PacifiCorp Has Failed to Quantify any Meaningful Ratepayer Benefits From that Proposal

78            For the reasons explained in Staff's initial Brief, the Commission should reject PacifiCorp's proposal to adopt full normalization of federal income tax on the basis the Company has not demonstrated any ratepayer benefit, and the underlying book-tax differences are more suitable to flow-through treatment.<sup>111</sup>

79            PacifiCorp's Initial Brief confirms the Company has not presented any evidence of real ratepayer benefit from its proposal. PacifiCorp broadly asserts full normalization would "create a clear and unambiguous policy" without justification, and current Commission policy creates "huge regulatory and accounting uncertainty."<sup>112</sup> However, the Company offers no proof for these extreme assertions. Indeed, this issue has been "alive" for decades, and PacifiCorp offers little of substance to suggest those issues are any more or less important now than before.

80            The Company says Staff offers no policy arguments in support of flow-through accounting.<sup>113</sup> While the Commission should not accept this invitation to shift the burden of proof away from the Company, the record shows Staff demonstrated how the Company's

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<sup>110</sup> Staff Initial Brief at 28, ¶ 117.

<sup>111</sup> Staff Initial Brief at 32 to 35, ¶¶ 132-144.

<sup>112</sup> PacifiCorp Initial Brief at 41, ¶100.

<sup>113</sup> PacifiCorp Initial Brief at 40, ¶ 98. PacifiCorp also states there that Staff admitted that normalization "upholds the matching principle and provides for intergenerational equity." However, the Company quotes Staff's testimony out of context. In fact, Staff made that statement in the context of presenting background for the arguments for flow-through and normalization. Breda, Exhibit No. KHB-1T at 4:3 to 5:13.

proposal did not provide any ratepayer benefit, and explained how the costs at issue are more amenable to flow-through accounting than normalization.<sup>114</sup> The record also shows Staff proved that the book-tax differences that reflect the Company's proposal to adopt full normalization increase the rate base \$5.4 million and the revenue requirement \$2.0 million, with no evidence of ratepayer benefit.<sup>115</sup>

81           The Company also says that Staff's adjustment to reflect flow-through is flawed.<sup>116</sup> However, it is the Company's case that is flawed because it fails to recognize that each book-tax difference that creates deferred tax on a normalized basis needs to be assessed separately to determine the impact of a policy of full normalization.<sup>117</sup> Nowhere does the Company provide that separate assessment.

82           This major flaw in the Company's case is clearly exposed by the Company's suggestion that this case is an "excellent opportunity for the Commission to authorize a move to normalization with minimal customer impact".<sup>118</sup> In fact, the Company's measure of this alleged "minimal customer impact" arises only by netting \$6.4 million in accumulated deferred tax related to regulatory assets against \$5.4 million in accumulated deferred tax related to accrued liabilities.

83           Notably, the Company's analysis treats that \$6.4 million on a flow-through basis, which is not accurate.<sup>119</sup> More to the point, this alleged "minimal impact" says nothing

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<sup>114</sup> Staff Initial Brief at 32 to 33, ¶¶ 132-137; Breda, Exhibit No. KHB-5T at 3:1 to 5:17; Exhibit No. KHB-2, Exhibit No. KHB-6, and TR. 749:3 to 752:1.

<sup>115</sup> See footnote 114, supra.

<sup>116</sup> PacifiCorp Initial Brief at 42, ¶ 102.

<sup>117</sup> Staff prepared this analysis in Ms. Breda's Exhibit No. KHB-6, as discussed in Staff's Initial Brief at 32-33, ¶¶ 135-137.

<sup>118</sup> PacifiCorp Initial Brief at 42, ¶101. The Company states that it demonstrated that full normalization "reduces" the test year revenue requirement. This is far from the truth. The Company actually has increased the revenue requirement by \$2.0 million, as Staff explained in its Initial Brief at 32-33, ¶¶ 135-137, Breda, Exhibit No. KHB-5T at 3:1 to 5:17, Staff Adjustment 7.9, Exhibit No. KHB-2, and Exhibit No. KHB-6.

<sup>119</sup> Staff Initial Brief at 31-32, ¶ 131 and at 32-34, ¶¶ 135-140.

about the ongoing impact of the Company's proposal. Thus, while the Company believes this is a net impact of a \$6,000 benefit to ratepayers,<sup>120</sup> that is completely misleading because it disguises the true ratepayer impact of the Company's proposal.<sup>121</sup>

84 Consider in this same regard the Company's lengthy discussion of what it calls "five particular book tax differences", and concluding that these assets comprise the effect of the Company's normalization proposal.<sup>122</sup> However, the truth lies elsewhere.

85 In fact, these five items represent regulatory assets, with Chehalis<sup>123</sup> accounting for almost the entire total. These five regulatory assets will be fully amortized by 2015,<sup>124</sup> and as such, cannot possibly represent the ongoing ratepayer impact of full normalization.<sup>125</sup> It is the underlying \$5.4 million of accumulated deferred income tax for ongoing accrued liabilities that represents the effect of full normalization.<sup>126</sup>

86 While Staff agrees these five items are before the Commission in this case,<sup>127</sup> it is important to emphasize that these regulatory assets are included on a normalized basis by both the Company and Staff.<sup>128</sup> That confirms that Staff's analysis of the true impact of normalization is what is imbedded both in the Company's and Staff's case.

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<sup>120</sup> Fuller, Exhibit No. RF-6 and Exhibit No. RF-12.

<sup>121</sup> Staff Initial Brief at 33 and 34, ¶¶ 138 to 140 and Breda TR. 753:12 to 755:12.

<sup>122</sup> PacifiCorp Initial Brief at 42, ¶102.

<sup>123</sup> The Company established the Chehalis regulatory asset pursuant to RCW 80.80.060(6), as acknowledged in *Utilities and Transportation Comm'n v. PacifiCorp*, Docket UE-090205, Settlement Stipulation at 4, ¶¶ 12-13.

<sup>124</sup> See footnote 123, supra. The Company is amortizing the Chehalis regulatory asset over six years beginning January 2010. All other regulatory assets mentioned will be fully amortized before that date.

<sup>125</sup> See footnote 121, supra.

<sup>126</sup> See footnote 114, supra.

<sup>127</sup> Breda, TR. at 753:12 to 755:12.

<sup>128</sup> Both Company and Staff Adjustments reflect taxes on a normalized basis for all five regulatory assets. Adjustments 4.4, Pension, 8.7, Powerdale, 7.10, Medicare and 8.10, Chehalis are reflected consistently in Foisy, Exhibit MDF-2 and Dalley, Exhibit RBD-6. The Grid West Regulatory asset was not identified as an adjustment by the Company and the taxes are normalized in the unadjusted results.



**B. Staff's Repairs Deduction Adjustment Reasonably Adjusts For a Known and Measurable, Cumulative and On-Going Accounting Change That Occurred During the Test Year**

87 While the Company suggests it is being charitable by “volunteering” normalization treatment of the Repairs Deduction,<sup>129</sup> the Company’s suggestion is based on the false assumption that the Commission would simply ignore the \$29.6 million<sup>130</sup> of cumulative ratepayer benefit from 1999 through 2008.

88 In this regard, PacifiCorp misrepresents Staff’s testimony regarding the tax accounting treatment of the Repairs Deduction. For example, PacifiCorp cites Ms. Breda’s testimony for the proposition that benefits from the Repairs Deduction could be lost under flow-through.<sup>131</sup> In fact, she was referring to lost benefits in the context of explaining the literal impact of flow-through on the accounting change for repairs deduction.<sup>132</sup> The Commission should not read that testimony to imply that for regulatory purposes, the Commission would simply ignore that ratepayer benefit.

89 The Company then tries to confuse the basis for Staff’s Adjustment 8.11, by saying Staff improperly proposes an additional \$14.5 million rate base reduction by annualizing the impact of the Repairs Deduction, though it was not reflected until September 2009.<sup>133</sup>

90 However, one thing is clear: the Company agrees that the actual cumulative adjustment reflecting this accounting change occurred in September 2009, which is during the test year.<sup>134</sup> Staff is simply reflecting the average rate base as if this cumulative accounting change was in place for the entire year. This is consistent with a restating

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<sup>129</sup> PacifiCorp Initial Brief at 40-41, ¶ 99.

<sup>130</sup> Breda, Exhibit No. KHB-1T at 13:2.

<sup>131</sup> PacifiCorp Initial Brief at 40-41, ¶ 99.

<sup>132</sup> Breda, Exhibit No. KHB-1T at 24:14-16.

<sup>133</sup> PacifiCorp Initial Brief at 45, ¶ 107.

<sup>134</sup> PacifiCorp Initial Brief at 45, ¶ 108.

adjustment reflecting the cumulative effect of the repairs deduction from 1999 to 2008,<sup>135</sup> as well as a pro forma adjustment representing a method change that reflects the entire period on the new basis.<sup>136</sup>

## VII. COST OF SERVICE/RATE SPREAD<sup>137</sup>/RATE DESIGN

### A. After Several Years of Uniform Percentage Increases, It is Time for Rates to Move Closer to Cost, and Recognize the Change in Demand Cost Allocation

91 ICNU and Public Counsel offer a superficial argument that the Commission should reject Staff's rate spread proposal because Staff uses the results of the Company's cost of service study, and the Commission's policy is to look to other factors as well, such as equity and gradualism.<sup>138</sup> ICNU goes so far as to suggest its rights have been violated by lack of notice of this alleged "policy change" which ICNU thinks is implicit in Staff's recommendation,<sup>139</sup> but that argument has no basis in reality, even if there were such a change.<sup>140</sup>

92 The fact is, there is no policy change, because Staff's rate spread proposal is not supported by mere "mechanical application" of the cost of service study results, as ICNU

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<sup>135</sup> Breda, Exhibit No. KHB-1T at 25:2-11.

<sup>136</sup> Staff Initial Brief at 36, ¶ 148.

<sup>137</sup> In its Initial Brief, ICNU uses Boise Inc. to raise the issue that industrial customers may not be able to afford the Company's proposed increase, and that may result in plant closures, or other adverse effects. ICNU Initial Brief at 4-5, ¶9, citing Nachbar, Exhibit No. NLN-1T at 1-2, 6-7. In fact, as Exhibit No. NLN-3 at page 1 shows, Boise Inc. enjoyed "record third quarter results" based on "strong volumes", and "favorable price levels", sufficient to justify a special dividend to shareholders in a total amount of \$32.3 million. Page 2 of that exhibit explains how Boise Inc. has been able to increase its prices and maintain them in the market, notwithstanding Mr. Nachbar's suggestion on page 6:11-13 of Exhibit no. NLN-1T that Boise Inc. is unable to pass costs on to its customers. This company's "strong earnings performance" and "robust cash position" (Exhibit No. NLN-3 at 1) belie any suggestion that closures or other adverse impacts are in the offing at Boise Inc., although it is possible that could occur for another PacifiCorp customer in the Company's Washington service area.

<sup>138</sup> Public Counsel Initial Brief at 40, ¶ 75; ICNU Initial Brief at 53, ¶ 100.

<sup>139</sup> ICNU Initial Brief at 56, ¶ 105.

<sup>140</sup> The Commission bases its rate spread decisions on the record before it, and the record here shows several rate schedules are not earning their allocated cost of service. If ICNU or Public Counsel wanted to make a case that "equity" or "gradualism" supports a different rate spread, they had every due process right to do so, including the opportunity to file cross-answering testimony.

contends.<sup>141</sup> First of all, Staff is not suggesting all schedules move to parity, but only gradually so, which advances the policy of gradualism.

93           Second, for the past several rate cases, the rate spread has been equal percentage,<sup>142</sup> which means there have been only minor changes in cost responsibility among the customer classes for many years. This has resulted in an imbalance featured by excessive stability on one side, and no gradualism on the other.

94           Staff's proposal is also supported by the fact that the cost of service study has changed the allocation of generation costs between energy and demand. There is no reason not to reflect in rates that shift in cost responsibility. By contrast, an equal percentage rate spread would inappropriately pretend there has been no change in cost responsibility.

95           Finally, ICNU and Public Counsel argue that because cost studies contain various assumptions, and changing the assumptions can change the results, a wide variance among classes in the cost study results should be of no concern to the Commission.<sup>143</sup>

96           First off, Public Counsel is in no position to make this argument, because it offered no change to the cost of service study whatsoever. ICNU challenged just a single item: the new demand cost allocation method, but ICNU supported that challenge with very weak analysis.<sup>144</sup> In short, the cost of service study is basically unchallenged on this record.

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<sup>141</sup>ICNU makes this charge repeatedly throughout pages 53-55 of its Initial Brief.

<sup>142</sup> *Utilities and Transportation Commission v. PacifiCorp*, Docket UE-032065, Order 06 (October 27, 2004) at 12, ¶ 27 (adopting recommendation in joint testimony for 75 percent of the average increase to Schedule 24, and equal percentage to all other schedules); *Utilities and Transportation Commission v. PacifiCorp*, Docket UE-061546, Order 08 (June 21, 2007) at 51, ¶ 206 (accepting equal percentage); *Utilities and Transportation Commission v. PacifiCorp*, Docket UE-080220, Order 05 (October 8, 2008) at 5, ¶ 16 (accepting equal percentage); *Utilities and Transportation Commission v. PacifiCorp*, Docket UE-090205, Order 09 (December 16, 2009) at 20, ¶ 58 (accepting equal percentage).

<sup>143</sup>ICNU Initial Brief at 53, ¶ 100; Public Counsel Initial Brief at 40, ¶ 74.

<sup>144</sup> Staff Initial Brief at 52, ¶¶ 209-212.

97 In the end, the Commission should adopt Staff's rate spread proposal because that proposal is based on the record, it reflects the change to the cost of the service study, and it responsibly counterbalances the past several years of equal percentage increases.

## **B. Rate Design**

### **1. A Monthly Customer Charge of \$7.50 is Supported by the Facts in the Record and Cost Causation Principles; The Opposition by The Energy Project and Public Counsel is Supported by Neither**

98 In Staff's Initial Brief, we demonstrated that a flat charge of \$7.50 is grounded in the facts and in principle, i.e., it is cost-based, consistent with principles of cost causation and sends the appropriate price signal.<sup>145</sup>

99 Without facts or cost causation principles at their disposal, Public Counsel<sup>146</sup> and The Energy Project resort to theoretical arguments that do not apply. First, they argue that in theory, deciding what costs to recover through a basic charge can be "subjective".<sup>147</sup> This theory does not apply, because the costs included in this case reflect no subjectivity whatsoever.

100 In fact, the meter, service drop, meter reading and billing<sup>148</sup> are real, concrete costs PacifiCorp actually incurs regardless whether the customer is using electricity,<sup>149</sup> and these costs vary by number of customers, not usage.<sup>150</sup> There is nothing subjective about that.

101 Next, they advance the theory that increasing the basic charge will discourage conservation,<sup>151</sup> and Public Counsel analogizes to FERC's policy regarding "straight fixed

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<sup>145</sup> Staff Initial Brief at 54-55, ¶¶ 219-224.

<sup>146</sup> Public Counsel presented no witness or evidence on the basic charge issue and conducted no cross-examination on the subject.

<sup>147</sup> Public Counsel Initial Brief 47-48, ¶¶ 92-94; The Energy Project Initial Brief at 20, 1<sup>st</sup> ¶. While it is correct that additional costs that vary by number of customers could legitimately be considered for recovery in the customer charge, that is not proposed in this case.

<sup>148</sup> Griffith, Exhibit No. WRG-1T at 4:15-16.

<sup>149</sup> Schooley, TR. 810:19 to 811:4.

<sup>150</sup> Schooley, TR. 778:21-23. We note also The Energy Project's point that in the long run, all costs are variable (TR. 778:19 to 779:15), but we are dealing only with the short run here; i.e., the rate year.

variable pricing” as a means to encourage gas usage, and thus discourage conservation.<sup>152</sup>

However, this case is completely unlike the case before FERC, who was considering a profound cost shift by means of a “fixed/variable” rate design. Here, we are talking about a mere 88 cents per customer per month.<sup>153</sup>

102 Obviously, 88 cents per month can neither discourage conservation nor encourage usage, and The Energy Project and Public Counsel have no evidence to the contrary.

103 Public Counsel apparently believes increasing the basic charge is illegal, by saying the proposed increase would “directly conflict” with RCW 19.285.020 and .040(1),<sup>154</sup> but those statutes simply require utilities such as PacifiCorp to acquire all conservation that is “cost-effective, reliable and feasible”. They have nothing to do with cost-based ratemaking or rate design in general, or increasing the customer charge in particular.

104 Finally, Public Counsel offers an argument that a cost-based customer charge would “unfairly burden low income customers.”<sup>155</sup> However, this argument refutes itself, because no one can be burdened “unfairly” when they are required to pay the costs they impose on the system. In any event, there are statutes, programs and tariffs in place to serve the interests of low income customers. There is no statutory or policy reason to depart from cost causation principles to serve those same limited interests when deciding on a widely applicable appropriate monthly customer charge, and certainly not when the amount at issue (88 cents per month) is minuscule.

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<sup>151</sup> Public Counsel Initial Brief at 46-47, ¶¶ 90-91; The Energy Project Initial Brief at 22-24.

<sup>152</sup> Public Counsel Initial Brief at 47, ¶ 91.

<sup>153</sup> As Mr. Schooley explained, the incremental impact of Staff’s proposed \$1.50 increase to the customer charge decreases the tail block rate.135 cents per kWh. Schooley, Exhibit No. TES-4T at 14:14-17. At an average Residential usage of around 15,000 kWh per year, that equals 1,250 kWh per month. Subtracting the first block of 600 kWh leaves 650 kWh in the tail block. Multiplying 650 kWh times \$0.00135 per kWh equals 88 cents/month, or \$10.56 per year.

<sup>154</sup> Public Counsel Initial Brief 46, ¶ 90 (the footnote text containing the statutory citation is on page 47).

<sup>155</sup> Public Counsel Initial Brief 45-46, ¶¶ 87-89, the quote is from the argument heading.

**2. The Commission Orders Relied on By Public Counsel to Oppose the Customer Charge Increase in Fact Support That Increase**

105 Public Counsel offers three Commission orders in an attempt to justify Commission rejection of the Staff-proposed increase to the customer charge.<sup>156</sup> In fact, those decisions fully support Staff's proposal.

106 In Docket UG-901459, the Commission said the record lacked a "calculation of the proper level for these charges", and told the parties they needed to "show their calculation of the proper level for these charges and explain the theoretical basis for the calculation."<sup>157</sup> Likewise, in Cause U-83-54, the Commission rejected the proposed customer charge increase "in the absence of better evidence of cost justification".<sup>158</sup>

107 In this case, Staff justifies the \$7.50 customer charge Staff proposes, and fully addresses the Commission's concern in those orders, as Mr. Schooley explained in his testimony.<sup>159</sup>

108 The third order Public Counsel points us to is from Docket UG-930134 et al., which involved Avista's Gas Decoupling Mechanism.<sup>160</sup> One of the issues involved in the consideration of decoupling was a proposal to increase the customer charge. The Commission was concerned the proposed customer charge increase might capture not only the lost margins associated with conservation, but any other lost margins as well.<sup>161</sup>

109 Like the other decisions Public Counsel relies on, this Avista decision presents no opposition to a cost-based customer charge. As we have described, the customer charge in

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<sup>156</sup> Public Counsel Initial Brief at 46-47, ¶ 91.

<sup>157</sup> *Utilities and Transportation Commission v. Washington Water Power Co.*, Docket UG-901459, Third Supplemental Order (March 9, 1992) at 17.

<sup>158</sup> *Utilities and Transportation Commission v. Puget Sound Power & Light Co.*, Cause U-83-54, Fourth Supplemental Order (September 28, 1984) at 42.

<sup>159</sup> Schooley, Exhibit No. TES-4T at 15:6-11.

<sup>160</sup> Public Counsel Initial Brief at 47, n. 211.

<sup>161</sup> *Utilities and Transportation Commission v. Avista Corp.*, Dockets UE-090134, UG-090135 & UG-060158 (consolidated), Order 10 (December 22, 2009) at 114, ¶ 292.

this case simply recovers the cost of the meter, service drop, meter reading and billing. No lost margins are involved.

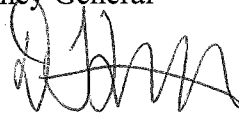
110 In sum, properly analyzed, the orders relied on by Public Counsel to oppose the Staff's proposed increase to the customer charge in fact fully support that proposal. The Commission should rely on the record, let common sense prevail, and approve an increase to the basic charge of \$1.50 per month, to \$7.50.

### VIII. CONCLUSION

111 For the reasons stated in this brief and in Staff's initial brief, the Commission should reject the tariffs PacifiCorp filed in this docket and permit the Company to file tariffs reflecting an overall rate increase of 9.5 percent, and consistent with Staff's rate spread and rate design recommendations described in detail above.

DATED this 18<sup>th</sup> day of February, 2011.

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